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TRANSFER OF STOCK CERTIFICATE AND LIEN OF CORPORATION.

Inasmuch as it did not appear from the report of the case of Norman *v.* Christo Mfg. Co., Inc., in the September issue of the REGISTER (see p. 348), that a writ of error had been applied for and refused by our Court of Appeals, and hence that the decision of the Law and Equity Court of Richmond in that case is now the established law of Virginia, I have thought that a statement of this fact, together with a review of some of the decisions of other states on the subject, would probably be of some interest.

It will be recalled that the case was as follows: Charles T. Norman was the bona fide holder for value and without notice of a certificate for twenty shares of the capital stock of Christo Mfg. Co., Inc., the certificate having been assigned to him by the party to whom it was originally issued. On its face were the following words: "This certifies that W. A. Loving is the owner of Twenty Shares of the capital stock of Christo Manufacturing Company, Inc., fully paid and non-assessable." Beneath were the signatures of the president and the treasurer, and the corporate seal, in the regular way. Charles T. Norman, having purchased the stock, applied to the corporation for a transfer of a certificate upon its books from W. A. Loving to himself. The corporation refused to make the transfer, giving as a reason therefor that the certificate had not been paid for by W. A. Loving. Norman therefore filed his petition in the Law and Equity Court of Richmond for a mandamus to compel the corporation to make the transfer and the corporation invoked the statute (Code 1904, § 1105e, clauses 28, 57, 58, 59) giving the corporation a lien for unpaid subscriptions and declaring that "no stock shall be assigned on the books without the consent of the corporation until all the money which has become payable thereon under the subscription agreement has been paid;" the Law and Equity Court declined to issue the mandamus, and the Court of Appeals, as

stated, was applied to for a writ of error, which was refused. Knowing that courts have differed as to the propriety of the mandamus as a remedy in a case of this sort, and feeling assured that it was upon a disapproval of this remedy that the writ was refused, the petition, having been first presented in vacation, was again presented under the statute to the Court in session at Richmond, in order that the reasons for the refusal of the writ might be made known. The writ was again refused, the Court stating that it was upon the merits of the case that this action was taken.

It may be well to state in justice to Mr. Loving that there was a disagreement between himself and the corporation as to whether the stock was paid for by him or not, and that the certificate was sent to him voluntarily by the president of the corporation, but this has no bearing on the question decided in the case.

Following is a portion of the petition to the Court of Appeals dealing with the principal question involved:

To the Honorable Judges of the Supreme Court of Appeals of Virginia:

Your petitioner, Charles T. Norman, represents that, on the 22nd day of December, 1911, he filed in the Law and Equity Court of the city of Richmond a petition for a mandamus against the Christo Manufacturing Company, Inc., whereupon such proceedings were had that a final judgment in the said cause was rendered against your petitioner, in the said court, on the 26th day of January, 1912, a transcript of the record of the proceedings in which cause, and of the judgment therein, is herewith exhibited.

Your petitioner is advised, and represents to your honors, that the said judgment is erroneous, and that he is aggrieved thereby in the following particulars, namely:

First Assignment of Error.—To the action and ruling of the court in overruling relator's demurrer to the answer of respondent.

Because the corporation, having issued a certificate of stock, upon which appeared the words "fully paid and non-assessable," is estopped to assert the statutory lien for the unpaid subscription against a *bona fide* assignee for value and without notice from the party to whom it was issued. The demurrer presented to the court this question.

In the case of Steacy *v.* Little Rock, etc., R. R. Co., 5th Dill. 348, the court held that "Where, under its charter, the directors of a railroad company issued shares of stock to a contractor for building its road as full-paid shares, * * * and such shares were sold by the contractor, in the public market, as full-paid shares, to purchasers for value, without actual notice of the equities between the contractor and the company, the holders of such shares are not subject to such equities, or liable to have the shares thus purchased treated as unpaid shares." The court in its opinion said (pp. 373-4): "The company's directors and officers are guardians of the company's rights. They ought not to issue shares in violation of their duty. They know whether the shares have been paid for or not. This the public have no means of knowing and no effectual means for ascertaining. If the company's directors, or other authorized officers, commit a fraud upon the company in this respect, they are undoubtedly liable therefor. But can any one point out wherein the equities of the creditor of a company thus defrauded by its officers are superior to the equities of those who have acted upon the representations of such officers within the scope of their powers, accredited by resolutions of the directors and authenticated by the corporate seal, and upon such solemn assurances purchased the shares of the company? * * *

The rights and obligations of a *bona fide* transferee of shares purporting to be full-paid shares are different from the rights and obligations of the transferee of shares which do not purport to be full-paid." P. 374. "Millions of dollars of stocks are sold in this country every week, and there is no practice on the part of purchasers and no understanding that the law requires of them that they shall ascertain *aliunde* the representations of the company's authorized officers that certificates of full-paid stock have in fact been fully paid."

"Fully paid-up shares mean shares upon which the whole amount that could be called has been called." Cook on Corporations, p. 241.

Where a certificate of stock on which appears a statement that the shares are fully paid is issued to a "holder who pays nothing to the corporation therefor, the company is estopped to deny the validity thereof as against a purchaser in good faith and for

value, and cannot refuse to recognize the latter as a stockholder or to record the transfer on its books, on the ground that it was illegally issued to, or acquired by, the vendor." Westminster Nat. Bank *v.* New Eng. El. Wks., etc., 73 N. H. 465. Also see Holbrook *v.* H. J. Zinc Co., 57 N. Y. 616.

If the *bona fide* holder were not protected, "no person buying shares in the market as paid-up shares would be safe, for he would get nothing more than a certificate to show they were paid-up. * * * Obviously such a construction would destroy the transferable nature of shares altogether." Burkinshaw *v.* Nicolls, L. R. 3 App. Cases 1004.

A "*bona fide* purchaser of stock * * * is protected now in almost every instance where he would be protected if he were purchasing a promissory note or other negotiable instrument." Cook on Corp., § 416, 10 Cyc., 483, § 3 and note 72, 176 U. S. 44, Am. Dec. Dig., § 175, Thomp. on Corp., Vol. 4, p. 867.

"The purchaser would be entitled to enjoy all the rights of membership to the same extent as the other shareholders, whose shares are represented by contributions to the company's capital." Morawetz on Corp., § 306. Also, § 286; 63 Cal. 359, 42 Cal. 147.

When a corporation issues stock as fully paid, it cannot afterwards assert the contrary though only a small per cent. of the value was in fact paid. Hill *v.* Ataka, etc., Co., 124 Mo. 153. Also, 19 L. R. A., N. S., 115 note, 83 Kan. 638, 15 Cur. Law 1140, Machen Mod. Law of Corp., § 800, 65 Mich., p. 126, 67 Fed. 434.

Under a Michigan statute similar to ours, which provided that a transfer upon the books of the bank can be made only by the consent of the directors, when the holder is indebted to it on matured paper, it was held that a statement by the cashier of the bank to a party making a loan with certificates of stock as collateral, estopped the bank from asserting the statutory lien on the stock. 113 Mich. 284.

The language there used was: "In reply, would say I do not hold any lien on said stock.

"Yours truly,

"E. C. CUMMINGS, *Cashier.*"

Is it possible that this or any other language can be stronger or more explicit than the words "fully paid and non-assessable," signed by the president and treasurer of the corporation under the corporate seal?

And the statutory lien may be waived by the act of the corporation either "expressed or implied." St. P. Nat. Bank *v.* Life Ins. Co., 71 Minn. 123.

The case of Gold *v.* Paynter, 101 Va. 714, cited by the court in the written opinion in the record, does not involve the question of stock issued as fully paid at all, and decides that "an assignee of stock is bound by an implied contract to pay unpaid installments."

The court itself distinguishes that case from the present one, for if the doctrine laid down in that case were applicable to this, of course the effect of it would be to establish the fact that the assignee in this case would be liable for unpaid installments, but the court says (p. 10 of record):

"Under circumstances such as exist here, an assignee is under no personal liability to pay either for past due or future assessment upon the stock, inasmuch as the certificate had been issued with the representation on its face that it was fully paid and non-assessable."

The court also (p. 12 of record) quotes 2 Cook on Corporations, 4th Ed., § 530, as follows:

"And the corporation may insist upon its lien and hold the stock even against a *bona fide* purchaser, inasmuch as purchasers are bound to take notice of legal liens."

It is submitted that this does not refer to stock issued as fully paid and hence does not involve the question here presented. The opinion then refers to § 531 of this author and says:

Mr. Cook treats of the circumstances under which a corporation is held to have waived its lien, but there are no circumstances in this case which form a proper basis for holding that the statutory lien has been waived."

Thus it failed to observe that this identical section contains the following language (p. 1437): "Accordingly where one buys stock on the faith of a representation of the corporate officers that the stock is unincumbered, he is entitled to the stock

free from any corporate lien." Moore *v.* Bank of Com. 52 Mo. 377.

The opinion of the court further quotes from Machen's Mod Law of Corporations, § 956, as follows:

"If the lien be created by statute, even a *bona fide* purchaser of the shares claiming under the transfer endorsed on the share-certificate would be subject to the lien for he has constructive notice."

It fails to observe that this author likewise, in the section immediately following (§ 957), in speaking of the circumstances under which a lien may be waived, says: "On the other hand, if the company leads the transferee to believe that the lien does not exist or will not be insisted upon, thereby lulling him into security and causing him to alter his position, the lien cannot subsequently be set up against him." Nat. Bank *v.* Watsontown Bank, 105 U. S. 217; Des Moines, etc., Trust Co. *v.* Des Moines Bank, 97 Iowa 668.

The case of Hammond *v.* Hastings, 134 U. S. 401, cited in the opinion of the court (p. 12 of record), does not apply to stock issued as paid up. The language of the certificate contains no such provision nor anything similar to it, and it cannot, therefore, affect the question raised in this case.

The case of Petersburg Savings, etc., Co. *v.* Lumsden, 75 Va. 327, cited by the court, decides the well-established fact that a lien is not discharged by an assignment of the certificate to a third party, as does also the case of Bohmer *v.* Bank, 77 Va. 445. The question here involved was not raised and not touched upon in either of these cases.

One case, that of Myers *v.* Seely, 17 Fed. Cases 1118, lays down a doctrine in some degree different from the established rule, although in that case the question was one between the creditors of the corporation and the assignee of the stock, and not between the corporation itself and the assignee, and decided that the creditors were not bound by the representations of the corporation to the effect that the shares were fully paid. Referring to this case, Mr. Cook says (Cook on Corp., p. 241, note): "This case must be considered poor law."

The authorities might be multiplied almost indefinitely, the

courts having held with practically complete unanimity, that whether the lien be created by a by-law of the corporation, by the provisions of its charter, or by a general law, (1) there is no liability on the *bona fide* assignee for something which the corporation itself has said does not exist, (2) that the title to the certificate in the hands of such a holder cannot be impeached, and, (3) as a corollary of the other two, that the *bona fide* holder has the right to demand the transfer of the stock on the books of the corporation. Some of the authorities cited bear upon one phase of the question, some upon another, but the underlying principle governing them all is the same, namely: that an individual cannot avoid the natural and probable consequence of his own deliberate act—the courts will not put into his hands a licensed weapon wherewith to defraud.

The importance of the decision may be appreciated when it is realized that under it a corporation may now, with apparently complete security, issue its certificates of stock upon which nothing whatever may have been paid, and put upon the face of them words indicating that they have been fully paid and are non-assessable, cause them to be put into the hands of such persons as they may select, who may dispose of them to any number of innocent parties, the purchaser, in the language of Burkinshaw *v.* Nicholls, getting no more than a certificate to show they were paid up;" the court in this case adding, what is undeniably true, that "obviously such a construction would destroy the transferable nature of shares altogether."

What effect this interpretation of the law of Virginia may have upon the sale of shares of stock of Virginia corporations heretofore readily dealt in throughout the country and accepted by the banks as collateral, will be a matter of more than ordinary interest. The purchaser of the stock of a Virginia corporation listed on the New York Stock Exchange, for example, buys it at his peril, for, no matter what the language on the certificate may be, he may find that he has bought nothing but a piece of paper of no value containing a recital to the effect that the same was fully paid and non-assessable. One of the very difficult features of the situation to deal with is the complete absence of any method by which the most prudent purchaser may be able to

protect himself. We may suppose that when such a person is offered a certificate of stock on which are the words "fully paid and non-assessable," signed by the duly authorized officers of the corporation and authenticated in solemn form by the corporate seal, he nevertheless, being suspicious that it may not have been paid for, addresses a letter to the president or secretary of the corporation telling him that such a certificate had been offered him, and asking whether it had in fact been fully paid, that his reply to this inquiry was that it was true that the certificate had been fully paid, that he then purchased it upon this assurance only to find later that it had not been paid and to realize that he had acted upon the faith of an assurance which did not and could not equal in solemnity that contained upon the face of the certificate itself and that his position was in nowise improved by a repetition of it in a less solemn form.

It is perhaps superfluous to add that the principle upon which the application for a mandamus was based is that of estoppel and that the law upon this subject in Virginia seems to afford the only exception to the well-established doctrine, and it is hardly conceivable that our legislature will fail to deal with the situation as soon as the opportunity is afforded it. In the meantime let us hope that the perfect trust which it is necessary that we shall place in any person who may see fit to offer us a certificate of stock may not be misplaced.

Caveat emptor.

ERNEST A. GRAY.

Richmond, Va.

Editorial Note.

We are forcibly impressed with the cogency of the argument here set forth. The position taken by the lower court on this question, and to which our court of appeals has lent its sanction, seems to us indefensible, and the very text-writers quoted to support it, state a qualification of the general rule which exactly covers this case and is directly contrary to the conclusions arrived at in this decision. We have re-read the opinion of the court with great care and made independent investigation of our own, and regret that we cannot escape the conclusion that this decision is wrong. It is difficult to say anything to add to the force of what is said here as to the applicability of the principles of estoppel to the conduct of the corporation here, by its duly authorized agents and officers, in issuing its stock

certificates as full paid and nonassessable. In Scoville *v.* Thayer, 105 U. S. 143, 21 L. Ed. 731, it is said that the corporation, after issuing its stock as paid-up stock, is estopped from proceeding to collect the unpaid part of the par value, either from the person receiving the stock or his transferee. The difference between the right to enforce payment of the unpaid amounts, which certainly does not exist, and the right to assert a lien on the stock and refuse to transfer it to a bona fide purchaser thereof, is merely one of degree. Is not the lien for the unpaid subscription value? And is not this to allow the corporation to use this lien to enforce the collection of money (or penalize its nonpayment) which we have just seen it has estopped itself from proceeding directly to collect? In other words the corporation cannot **make** the bona fide purchaser pay twice for the stock, but it can keep the stock from him until he voluntarily (?) does pay twice for it, or abandons his claim thereto. We fail to see how the statutory provisions change the equities of the case and the rules of equitable estoppel. A man or a corporation may waive, or be estopped to enforce, rights under a statute as well as any other rights, which, but for his misleading action, he could freely exercise.

J. F. M.